No. 12,960

IN THE

United States Court of Appeals

For the Ninth Circuit

HARDWARE MUTUAL INSURANCE CO. OF MINNESOTA, a corporation,

Appellant,

vs.

MILDRED A. DUNWOODY, HAROLD A. GOLDMAN, MYRTLE GOLDMAN, HAROLD F. BARUH, and DORIS G. BARUH,

Appellees.

APPELLANT'S REPLY BRIEF.

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STATEMENT OF THE CASE.

Lessee appellees charge (2-5) that appellant "has omitted" from its statement of the case "essential" facts. That this charge is unfounded is readily demonstrated by a brief notice of the supposed omissions, claimed to be four in number.

(1) The terms of the subrogation clause in appellant's policy. This clause will be found quoted in full in our brief (15).

(2) The fire was due to causes unknown. This fact is and always has been undisputed, and is implicit in our entire discussion of the case.

(3) The terms of paragraph 12 of the lease. This paragraph is fully discussed in our brief (2-3; 18). The essentiality of the last sentence of paragraph 12 as quoted by lessee appellees (3) nowhere appears, since appellees do not refer to it elsewhere.

(4) The policy issued by Security Insurance Company. This policy is referred to in our statement of the case (4). The "essential" facts concerning it are contained in lessee appellees' statement of the case (3-4); but lessee appellees do not trouble to point out in argument why or in what manner these facts are "essential" or even relevant.

REPLY TO ARGUMENT OF LESSEE APPELLEES.[1]

I. SUBROGATION OF INSURER TO CONTRACT RIGHTS OF ITS INSURED.

Lessee appellees concede (19) that the English rule grants subrogation to an insurer to those rights of its insured which arise from contract as well as to those which arise from tort liability; and further concede (19) "that there are American cases, including those cited by appellant[2] which purport to follow the English rule * * *"

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[1]Designation of subdivisions (I, II, and III) under this point follow the designations found in the brief of lessee appellees.

[2]These authorities will be found on pp. 8-14 of our brief. They include textual statements from the article on insurance law in *Corpus Juris Secundum,* and from the insurance treatises of *Apple-*

These authorities lessee appellees brush cavalierly aside by saying (19):

> "These cases are distinguishable from the instant case in that in every one of said cases the third party was responsible and agreed to pay for the loss insured against, whereas in the instant case the lessee appellees were not responsible and did not agree to pay for the loss insured against, but merely to rebuild the buildings destroyed by fire."

So far as this "distinction" is concerned, we submit that it is a distinction without a difference—a distinction in phraseology without underlying substance.

It is, of course, true that in every case ever decided where subrogation was successfully pursued by an insurer against a third party, the third party "was responsible * * * for the loss insured against"; this is obviously a *sine qua non* of subrogation. We categorically deny, however, that the cases cited are cases where the third party agreed "to pay for the loss insured against" rather than to "rebuild" (or repair) the property damaged by fire.[3] For example, in *Chicago etc R Co v Pullman etc Co* (1890) 139 US 79, 11 SCt 490, 35 LEd 97,[4] the agreement by the third party (lessee of railroad cars) was that it should—

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man, Couch, and *Joyce.* They also include case law from decisions of the United States Supreme Court and other federal courts, and from the states of California, Connecticut, New York, Oregon, and West Virginia.

[3]Note that lessee appellees say (19) that this is true of "every one" of the cases cited by us.

[4]Appellant's Brief, p. 11.

> "repair all damages to said cars of every kind occasioned by accident or casualty during the continuance of this contract * * *" (139 US 82, 35 LEd 99.)

This was the agreement or obligation to which the Supreme Court decreed the insurer was entitled to be subrogated.

Lessee appellees (15-15) cite, quote at length from, and rely upon *American Surety Co v Bank of California* (CCA 9, 1943) 133 F2 160, as establishing the rule in this circuit, contrary to the authorities cited by us, that an insurer will not be subrogated to the rights of an insured arising under a contract with a third person. The *American Surety* case, however, is not only not authority for the proposition to which it is cited by lessee appellees, but is rather persuasive authority in support of appellant's position. In that case this Court took pains to point out that its decision denying subrogation under the facts involved[5] was not inconsistent with or contrary to the decision in *Chicago etc R Co v Pullman etc Co* (1890) 139 US 79, 11 SCt 490, 35 LEd 97, which is one of the line of authorities upon which appellant relies. After stating the facts in the *Pullman* case, this Court said (133 F2 164):

> "In the case at bar there was no express contract on the part of Bank in favor of Interior

[5]These facts were in no way analogous to a fire loss subrogation situation. They concerned the attempted subrogation of an insurer covering a depositor against loss caused through dishonesty of its employee against a bank which cashed fraudulent checks drawn by the employee on the depositor's account.

(the depositor) as there was on the part of the railroad in the Pullman case * * * Therefore, the Pullman case is not authority in favor of Insurers herein."

It is of interest to note that the *American Surety* case arose in Oregon. An interesting discussion of the views of the Supreme Court of Oregon on the right of an insurer to be subrogated to contract rights of an insured is found in *National Fire Ins Co v Mogan* (Or 1949) 206 P2 963, 968-9. The court pointed out that the subrogation doctrine as stated by the English courts in the cases of *Darrell v Tibbitts* and *Castellan v Preston*[6] has been followed by many American courts; and that *Plate Glass Underwriters Mutual Ins Co v Ridgewood Realty Co* (Mo 1925) 269 SW 659,[7] "represents a contrary view".

Lessee appellees state (17) that the views of the California Supreme Court on the question of subrogation to contract rights "are in accord" with those of the Court of Appeals of this Circuit.[8] They cite *Meyer v Bank of America etc Assn* (1938) 11 C2 92, 77 P2 1084. The *Meyer* case is admittedly on all fours factually and legally with the *American Surety* case, and for the reasons noted above is not therefore helpful to appellees.

We shall next comment upon the only two cases cited by lessee appellees which to any degree at all support their position with respect to subrogation.

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[6]Appellant's Brief, pp. 12-13.
[7]This case is cited by lessee appellees, and is discussed below.
[8]We do not disagree with this statement.

(1) *Plate Glass Underwriters Mutual Ins Co v Ridgewood Realty Co* (Mo 1925) 269 SW 659, is discussed by lessee appellees at length (9-11). We concede that there is language in this case which, as pointed out in the Oregon case of *National Fire Ins Co v Mogan* (supra), "represents a contrary view" to that expressed by the English cases and the considerable weight of American authority. Nevertheless, this language (as lessee appellees neglect to point out) is dictum, because the court had already determined that the third party landlord was not obligated under the terms of the lease to make the repairs for which the insurer had paid; and it had also determined that even if he had been so obligated he would have been entitled to notice of the damage and a reasonable opportunity to make the repairs himself—neither of which conditions were met. These determinations were, of course, fatal to any right of subrogation because they were fatal to any right of recovery on the part of the insured to which the insurer could be subrogated.

There can be no dispute but that the dictum in the *Plate Glass* case represents a minority view. In addition to the authorities cited in our brief, we call attention to the cases of *Container Co v United States* (Ct Claims, 1950) 90 FS 689, 694:

> "The insurers, by paying for the damage, became subrogated to the insured's contract claim against the United States."[9]

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[9]Footnote 11 appended by the court to the foregoing holding refers to the English and American authorities, and observes:

> "Some American courts have not allowed subrogation to contract claims * * * But the general rule is that an insurer is

and *Borserine v Maryland Casualty Co* (CCA 8, 1940) 112 F2 409, 414, footnote 2. One of the cases cited in this footnote is *Iowa State Ins Co v Missouri etc R Co* (Mo 1928) 9 SW2 255, 256. This case would appear to cast some doubt upon the validity of the *Plate Glass* dictum as authority even in Missouri, because although the case itself involved subrogation against a tort-feasor it cites as among "the leading authorities" on subrogation the case of *Potomac Ins Co v Nickson* (Utah 1924) 231 P 445, 42 ALR 128. In the *Nickson* case subrogation was upheld in favor of an insurer against a third party liable to the insured under a contract of bailment. The automobile had been garaged with defendant and a claim check issued. Defendant misdelivered the car, but claimed there was no negligence on his part. The trial court held that the defendant was liable to the insurance company by way of subrogation under the contract of bailment, and refused to submit the question of negligence to the jury. This was affirmed on appeal. The court said that the contract of bailment was breached by failure to redeliver the car, and that good faith or negligence of the defendant was immaterial; the insurer was held entitled to be subrogated to the contract rights of its assured.

(2) *Alexandra Restaurant v New Hampshire Ins Co* (1947) 71 NYS2 515 is the other case cited by lessee appellees (11-13) which tends to support appellees' position. It should be noted, however (since lessee appellees do not disclose the fact),

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subrogated to the insured's right of indemnity from a third party in contract as well as in tort * * *"

that the court expressly refused to pass upon the question of what subrogation rights the insurer might have asserted under the policy if the case had involved the question of subrogation. The court said that inasmuch as there had been neither payment of the loss nor recognition by the insurer of any liability to pay anything under the policy, it was unnecessary to determine the scope of the subrogation clause contained in the policy. In the *Alexandra* case the lessor had completely repaired the building prior to the suit by the lessee against its insurer. The insurer contended that judgment should be in its favor in order to avoid double indemnity and an apparent profit to the insurer lessee.

The court recognized that such would be the result under the English doctrine of subrogation, but held otherwise upon the strength of "the weight of controlling authority in this state"—that is, in New York. No attempt was made by the court to ascertain or discuss the general weight of American authority. Apart from the leading English cases, the opinion does not refer to any cases from other than New York courts, although, as our opening brief sufficiently shows (8-14), many such decisions exist, and it has but recently been authoritatively stated that the general rule is contrary to the conclusion reached by the New York court (46 CJS 154-5: Insurance, s 1209, n 17-20).

Moreover, the *Alexandra* case recognizes that the New York authorities cited in the opinion are not entirely harmonious. The court might have gone farther

along these lines and pointed out that in at least two other decisions not referred to in the opinion, the New York courts have subrogated an insurer to contract rights of the insured. In *Interstate Ice etc Corp v US Fire Ins Co* (NY 1926) 152 NE 476, a fire insurer was required to pay the conditional vendor (its insured) the balance due under the conditional sale contract after a partial destruction of the property by fire; the court pointed out that upon such payment the insurer would "succeed by subrogation to the remedies available against the conditional vendee". In *Agricultural Ins Co v Rothblum* (1933) 265 NYS 7, property was lost while in the possession of a bailee. The insurance company paid the value of the property to the insured owner and in this action against the bailee was held entitled to be subrogated to all the rights of its insured under the contract of bailment. The court in the *Alexandra* case might also have noted that in New York it is well settled that under a single interest policy issued to a mortgagee, the insurer upon payment of a loss is entitled to be subrogated to the contract (mortgage) rights of the mortgagee against the mortgagor. *Excelsior Fire Ins Co v Royal Ins Co* (1873) 55 NY 343, 14 AmRep 271, as quoted with approval in *Fields v Western etc Ins Co* (NY 1943) 48 NE2 489, 146 ALR 434, 438.[10]

We submit that, in addition to being at variance with the controlling weight of English and American

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[10]The *Fields* case is cited upon this point in our opening brief (9-10).

authority, the *Alexandra* case is wrong in principle because it violates the fundamental doctrine that a contract of property insurance is a contract of indemnity.

> "The doctrine of subrogation was adopted by equity to put the burden of loss on the one primarily responsible for it. This right of subrogation arises out of the nature of the contract of insurance as a contract of indemnity, the carrier being primarily and the insurer secondarily liable. The insurer's right of subrogation exists as a matter of equity, and is not dependent upon the reservation of the right in the contract of insurance." *National Garment Co v N Y etc R Co* (CA 8, 1949) 173 F2 32, 37.

Finally, it is significant that many if not most of the cases dealing with problems of subrogation cite both tort and contract subrogation cases indiscriminately as authority for allowing subrogation in either type of case. See, for example, *Grace v United States* (DC Md, 1948) 76 FS 174, 176, a tort subrogation case which relies upon a number of Supreme Court cases dealing with subrogation to contract and statutory rights of the insured.

II. DO LESSEE APPELLEES CLAIM TO BE ENTITLED TO THE BENEFIT OF THE PROCEEDS OF APPELLANT'S POLICY?

Lessee appellees object (26) to the statement in our brief (20) that they claim that the proceeds of appellant's policy inure to their benefit.

We suggest that this objection is made by lessee appellees with reservations. They are very careful to say (26) that they have made no claim to the proceeds *"in the pleadings"* or *"in this action"*. And, although they assert (6) that they "do not question their obligation to rebuild", they are careful to insist (6) that this obligation runs only to appellee Dunwoody and that appellant must not "be given the right to interfere in the performance, *or non-performance,* or any *negotiations* in relation to, or any *adjustment* of, said obligation".

On the other hand, if lessee appellees do in all good faith concede their obligation to rebuild and their lack of beneficial interest in the proceeds of appellant's policy, we submit that they have no standing to resist appellant's position upon this appeal as the issue of appellant's right to be subrogated to appellee Dunwoody's rights against appellee lessees would appear to be moot as to them.

III. FRCP, RULE 54(c).

Lessee appellees controvert (27) the application of Rule 54(c) FRCP to the prayer of appellant's complaint[11] on the ground that the rule applies only when the party invoking it has been successful in the trial court. They cite no case in support of this position.

The authorities are to the contrary.

Schoonover v Schoonover (CA 10, 1949) 172 F2 526;

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[11]See, Appellant's Opening Brief, p. 8, n. 1.

Roth v Fabrikant Bros (CA 2, 1949) 175 F2 665;

Broidy v State etc Assur Co (CA 2, 1950) 186 F2 490.

REPLY TO ARGUMENT OF APPELLEE DUNWOODY.

In the main, the brief of appellee Dunwoody adopts the arguments made by lessee appellees in their brief. However, a few "other considerations" are mentioned in the Dunwoody brief (10). Only the following points, advanced as they are without argument, require comment.

It is said that "there has been no proof that the buildings may be restored". This is true, but the rights which appellant seeks to have declared will not prejudice appellee Dunwoody in either case. If the buildings are restored by lessee appellees, appellee Dunwoody will not require the proceeds of appellant's policy to be made whole—indeed, she will have been made more than whole without these proceeds for she will have gotten new buildings for old. If the buildings are not restored, appellant will be subrogated *pro tanto* to her rights under the lease, subject in all events to her prior right to have full indemnification for her loss.

It is also said that "there is no proof of the cost of restoration". This is true, but is immaterial to the issues involved in this action.

It is said further that appellee Dunwoody may elect to take the insurance money, cancel lessee appellees' lease, and rebuild the buildings herself; and

it is implied that appellant's position is "absurd" because it might prevent this course of action. There would be nothing in the judgment sought by appellant that would prevent appellee Dunwoody from taking the proceeds of appellant's policy and using them to rebuild. It is true, however, that she would not be in a position to destroy the obligation of lessee appellees to rebuild; this is a necessary and inevitable concomitant of appellant's right of subrogation.

Dated, San Francisco, California,
31 October 1951.

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